

DEPARTMENT OF STATE REVENUE

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 96-0443

**Individual Income Tax
For Tax Periods 1990-1996**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Income Tax—Imposition

Authority: IC 6-8.1-5-1

Taxpayer protests the imposition of Indiana adjusted gross income tax.

II. Tax Administration—Penalty

Authority: IC 6-8.1-10-4; 45 IAC 15-5-7

Taxpayer protests the imposition of a one-hundred percent (100%) penalty.

STATEMENT OF FACTS

The taxpayer was arrested by Vigo County law enforcement officials in May, 1996. The law enforcement officials seized \$590,859.00 in cash from a car driven by taxpayer and from taxpayer's hotel room. The taxpayer did not file income tax returns for 1991, 1992, 1993, 1994 and 1995. The Indiana Department of State Revenue issued income tax assessments on the cash. The taxpayer protested the assessments, and requested that no hearing take place until after the connected federal trial was resolved. The Department granted this request. After that trial was completed, an administrative hearing was scheduled to be held over the telephone. Taxpayer's representative failed to call and the Letter of Findings was written based on the information in the file. Taxpayer's representative requested a rehearing, explaining that there had been legal proceedings which established that the bulk of the cash seized was not attributable to taxpayer and that there was documentation to support that position. The rehearing was held over the telephone and the documentation was sent to the Department through the mail. This Supplemental Letter of Findings is written based on all information in the file.

I. Income Tax—Imposition

DISCUSSION

Taxpayer was arrested in May, 1996 by the police, with \$590,859.00 in the car he was driving and in his hotel room. Taxpayer failed to file income tax returns for the years from 1990 to 1995. The Department assessed income taxes for the years involved, based on the amount of cash seized, and taxpayer protested. Taxpayer failed to submit any documentation to support the position that the cash was not his. Pursuant to IC 6-8.1-5-1, the taxpayer failed to meet his burden of proving that the proposed assessments were wrong, and the protest was denied.

As part of the requested rehearing, taxpayer's representative provided a copy of a legal document between the taxpayer and the Federal government which establishes that only \$1,438.00 of the seized cash is attributable to taxpayer. IC 6-8.1-5-1 states in part:

The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid, and the burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.

Since taxpayer has provided documentation to establish that the bulk of the cash in question did not belong to him, he has met the burden imposed by IC 6-8.1-5-1. Only the \$1,438.00 is attributable to taxpayer.

FINDING

Taxpayer's protest is sustained. Taxes for the years in which no return was filed will be recomputed based on the \$1,438.00 attributable to taxpayer.

II. Tax Administration—Penalty

Taxpayer asked the Department to waive the one hundred percent (100%) fraud penalty imposed along with these assessments. In establishing the fraud penalty, IC 6-8.1-10-4 provides:

- (a) If a person fails to file a return or to make a full tax payment with that return with the fraudulent intent of evading the tax, he is subject to a penalty.
- (b) The amount of the penalty imposed for a fraudulent failure described in subsection (a) is one hundred percent (100%) multiplied by:
 - (1) the full amount of the tax, if the person failed to file a return; or
 - (2) the amount of the tax that is not paid, if the person failed to pay the full amount of the tax.
- (c) In addition to the civil penalty imposed under this section, a person who knowingly fails to file a return with the department commits a Class A misdemeanor.

- (d) The penalty imposed under this section is imposed in place of and not in addition to the penalty imposed under section 2 of this chapter.

45 IAC 15-5-7(f)(3) provides that there are five elements to fraud, by stating:

A person who files a return which makes a false representation(s) with knowledge or reckless ignorance of the falsity will be deemed to have filed a fraudulent return. There are five elements of fraud.

- (A) Misrepresentation of a material fact: A person must truthfully and correctly report all information required by the Indiana Code and the department's regulations. Any failure to correctly report such information is a misrepresentation of a material fact. Failure to file a return may be a misrepresentation.
- (B) Scienter: This is a legal term meaning guilty knowledge of a state of facts, such as evasion of tax, which it was a person's duty to guard against. A person must have actual knowledge of the responsibility of reporting the information under contention. However, the reckless making of statements without regard to their truth or falsity may serve as an imputation of scienter for purposes of proving fraud.
- (C) Deception: Deception operates on the mind of the victim of the fraud. If a person's actions or failure to act causes the department to believe a given set of facts which are not true, the person has deceived the department.
- (D) Reliance: Reliance also concerns the state of mind of the victim and is generally considered along with deception. If the person's actions, failure to act, or misrepresentations cause the department to rely on these acts to the detriment or injury of the department, the reliance requirement of fraud will be met.
- (E) Injury: The fraud instituted upon the department must cause an injury. This can be satisfied simply by the fact that the misrepresentation(s) caused the department not to have collected the money which properly belongs to the state of Indiana.

In order to demonstrate fraud, the department is required to prove all of the above elements are present. This must be shown by clear and convincing evidence.

In this case, all five elements are present. Misrepresentation of a material fact is present due to the fact that taxpayer failed to correctly report all information required by the Indiana Code and the Department's regulations. Taxpayer failed to file Indiana Income Tax returns for the years 1990, 1991, 1992, 1993, 1994 and 1995. 45 IAC 15-5-7(f)(3)(A) states, "Failure to file a return may be a misrepresentation."

Scienter is present due to the fact that taxpayer had actual knowledge of the responsibility of reporting actual income, as evidenced by the fact that taxpayer submitted returns in previous years. Those returns have a caption directly above the signature line, which

states, "...under penalty of perjury, I have examined this return and all attachments and to the best of my knowledge and belief, it is true, complete and correct...". Taxpayer signed those returns and later failed to file complete and correct returns for the years 1990 through 1995, thereby failing the duty to guard against evasion of tax, as described in 45 IAC 15-5-7(f)(3)(B). Each year taxpayer failed to file a return, it was a statement to the Department that taxpayer had no income and owed no income tax to Indiana. It has been established that taxpayer did have income in those years, as evidenced by the \$1,438.00 taxpayer agreed was his, and that taxpayer did know that there was a duty to file true, complete and correct returns. This is sufficient to establish scienter.

Deception is present due to the fact that the Department had no reason to believe that taxpayer should have filed returns. Reliance is present due to the fact that the Department relied, to its detriment, on taxpayer to file returns for the six years in question. Injury is present due to the fact that the Department was unable to collect the money which rightfully belonged to the state of Indiana. There is clear and convincing evidence that all five elements of fraud are present, therefore the penalty is appropriate.

FINDING

Taxpayer's protest is denied.